Securities Litigation Developments Largely Expected to Shift From Supreme Court to District and Circuit Courts in 2015

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As observed in the 2014 edition of *Insights*, the Supreme Court stood poised last term to resolve a number of noteworthy issues with the potential to affect the securities litigation landscape. In *Chadbourne & Parke, LLP v. Troice*, 134 S. Ct. 1058 (2014), the Supreme Court clarified that the Securities Litigation Uniform Standards Act applies only "where the misrepresentation makes a significant difference to someone's decision to purchase or to sell a covered security," and in *Lawson v. FMR, LLC*, 134 S. Ct. 1158 (2014), it held that the whistleblower protections under Sarbanes-Oxley apply to employees of a public company's private contractors and subcontractors. In its much-anticipated opinion in *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014), and as explored further below, the Supreme Court reaffirmed the applicability of the fraud-on-the-market presumption of reliance, but also definitively confirmed a defendant's right to rebut the presumption at the class certification stage by presenting evidence that the alleged misrepresentations did not affect the stock's price.

Although the number of settlements remained at a nearly 20-year low, the number of new federal securities class action filings remained essentially unchanged last year as compared to the average over the previous five years. Despite such apparent stability, the landscape and potential strategic responses to federal class action securities litigation continue to evolve, and important ever-present considerations remain for all publicly traded companies. Recent developments notwithstanding, many uncertainties in the law remain, and we anticipate further evolution in several areas in 2015.

Does Section 11 Require Statements of Opinion or Belief to Be Reasonable?

The U.S. Supreme Court likely will decide in the next few months whether opinion statements that later prove false, regardless of whether the speaker believed them to be true when made, are actionable under Section 11 of the 1933 Securities Act, 15 U.S.C. § 77k.

The Second, Third and Ninth Circuits have held that an opinion statement is actionable under Section 11 only if (1) the statement later turned out to be incorrect (the "objective falsity" requirement) and (2) the speaker did not actually believe the statement to be true at the time it was made (the "subjective falsity" requirement). Conversely, the Sixth Circuit recently held in *Indiana State District Council of Laborers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013), that Section 11 claims are predicated upon strict liability and thus can proceed solely on the basis of allegations of objective falsity (*i.e.*, rejecting any subjective falsity requirement).

The Supreme Court heard oral argument on November 3, 2014. The petitioner, Omnicare, argued that Section 11 imposes liability only if both the objective and subjective falsity predicates are met, contending that an opinion statement cannot be false if the speaker genuinely believed in the truth of the statement at the time it was made. The respondents — investors who purchased Omnicare securities in a 2005 public offering — argued that Section 11 is a strict liability statute and thus consideration of a speaker's state of mind concerning a challenged opinion statement is not relevant and issuers should be held liable for opinions that turn out to be incorrect.

Neither view appeared to move the Supreme Court as much as the government's proffered "reasonable basis" approach to assessing Section 11 opinion liability. This "middle ground" test is essentially an attempt to harmonize the circuit court split and focuses the inquiry on whether (1) the speaker genuinely believed the opinion at the time it was made and (2) there was a reasonable basis for believing that opinion to be true. Speculation abounds, but a consensus is growing that the Court will move toward this type of composite formulation rather than picking among the current poles.

To be sure, the seeming ambiguity of what might constitute a "reasonable basis" underlying the belief required to satisfy the government's proposed standard is a legitimate concern (as noted in questions posed by Justice Samuel Alito at oral argument). Additionally, adopting a "reasonable basis" standard could unfairly disadvantage issuers seeking resolution at the pleading stage, because what constitutes a “reasonable basis” likely would be argued by the plaintiffs' bar to involve a fact-intensive inquiry that only should be resolved at the summary judgment stage after discovery.

However, adoption of a "reasonable basis" inquiry would repudiate in an important way the Sixth Circuit's approach to opinion statements — which untethered opinions from their judgmental basis despite the fact that such statements of belief are by definition uncertain and, in some instances, may later turn out to be incorrect. Indeed, opinions that often are at issue in Section 11 cases — loan loss and other similar reserve determinations, litigation outcome estimates, goodwill and other judgmental assessments — could become more problematic to defend if plaintiffs are only required to plead objective falsity. Rather, by requiring plaintiffs to plead nonconclusory facts from which to infer that the speaker lacked an appropriate basis for the opinion or belief, the Court would preserve an important minimum pleading baseline that plaintiffs must meet to survive dismissal.

After *Halliburton*: Assessing the Preliminary Effects as Courts (Re)Consider Evidence of 'Price Impact' at Class Certification

In June 2014, the U.S. Supreme Court issued perhaps its most anticipated securities law opinion in recent years if not decades, *Halliburton Co. v. Erica P. John Fund, Inc.* , 134 S. Ct. 2398 (2014) (*Halliburton II*), which revisited the fraud-on-the-market theory first integrated into federal securities law by *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Essentially, the fraud-on-the-market theory provides class action plaintiffs with a presumption of reliance on the market price of a stock so long as the stock was traded in an efficient market, the alleged misrepresentation was material and known to the public, and the investor purchased stock after the alleged misrepresentation was made. This presumption is a rebuttable one, and the Court long ago articulated in *Basic* that "any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." *Basic*, 485 U.S. at 248.

In *Halliburton II*, the Court reaffirmed the viability of the fraud-on-the-market theory, but reiterated that the "burden of proving th[e] prerequisites still rests with plaintiffs and (with the exception of materiality) must be satisfied before class certification." The Court likewise reaffirmed a defendant's right to rebut the presumption of reliance by "appropriate evidence," and clarified that one way of doing so is by offering "evidence that the asserted misrepresentation (or its correction) did not affect the market price of the defendant's stock."

The Supreme Court's unambiguous approval of a defendant's right to contest "price impact" at class certification is important, even if it only affirmed the standards already prevailing in some circuits. The Second Circuit, for example, previously endorsed consideration of event studies and other evidentiary tools in order to demonstrate "no impact" on price.

However, the Court did not address several important practical uncertainties.

For example, what evidentiary burden must a defendant satisfy to demonstrate a lack of price impact? Thus far, no answers have emerged from the district court after the Supreme Court remanded the case in *Halliburton II*. However, the Halliburton defendants have renewed their argument in the district court that the plaintiffs were not entitled to a presumption of reliance because the alleged misrepresentations had no price impact, asserting that "[n]either the Supreme Court nor Justice Ginsburg's concurrence … ever stated a defendant must 'prove' a lack of price impact by the preponderance of the evidence," and therefore that the burden to demonstrate a lack of price impact "is one of evidentiary production, not ultimate persuasion."

Some of the first post-*Halliburton II* district court decisions, however, have drawn that assertion into question. In *McIntire v. China MediaExpress Holdings, Inc*., No. 11-cv-0804 (VM), 2014 WL 4049896, at *13 (S.D.N.Y. Aug. 15, 2014), the court determined that the "defendant bears the burden to prove a lack of price impact" — which the court noted could be shown through an increase or the absence of a decrease in price. The auditor defendant in that case could not forestall certification because it had not "met its burden to prove that its alleged misstatements did not improperly maintain [the] already-inflated stock price."

In that same vein, the court in *Aranaz v. Catalyst Pharmaceutical Partners, Inc.*, 302 F.R.D 657 (S.D. Fla. 2014), determined that "defendants have the burden of rebutting the presumption of price impact," which was characterized as an "onerous" and "daunting" task. Indeed, the court further observed that "proving an absence of price impact seems exceedingly difficult, especially at the class certification stage in which it must be assumed that the alleged misrepresentation was material." Similarly, a recent decision in *Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Financial Corp.*, No. CV-10-J-2847-S, 2014 WL 6661918 (N.D. Ala. Nov. 19, 2014), relying in part on *Catalyst* and expressly remanded by the Eleventh Circuit to consider evidence of lack of price impact, concluded that "nothing in Halliburton II requires the plaintiffs to produce an event study in opposition to defendants' event study on a class certification motion."

To be sure, *Halliburton II* confirmed that evidence of any price impact must be considered at class certification. While that much is certain, other more practical questions — including whether there is a quantitative as well as a qualitative evidentiary burden a defendant must overcome to demonstrate lack of price impact; if and how dueling expert reports will be resolved; and whether Rule 23's own mandates ever cause the burden to shift back to plaintiffs — must await guidance from the lower courts and, ultimately, more definitive resolution by the circuit courts. It may be that another trip to the Supreme Court will be necessary to fully answer those and other remaining questions. Until that time, issuers and their advisers likely will continue to weigh how robustly to challenge class certification in order to preserve the above issues for leverage during any settlement negotiations and to ensure that they remain a part of the arsenal available for summary judgment and trial.

Omnicare Also May Shape the Contours of Corporate Scienter

In another recent decision involving *Omnicare — Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Securities Litigation*, 769 F.3d 455 (6th Cir. 2014) — the Sixth Circuit articulated its standard for imputing scienter under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. The Sixth Circuit explained that the knowledge of only three categories of individuals may be imputed to a corporation: "(a) the individual agent who uttered or issued the misrepresentation; (b) any individual agent who authorized, requested, commanded, furnished information for, prepared … reviewed, or approved the statement in which the misrepresentation was made before its utterance or issuance; (c) any high managerial agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance of issuance." Applying this clarified approach to the assessment of corporate scienter allegations, the Sixth Circuit affirmed the dismissal of Section 10(b) claims against Omnicare and several of its current and former officers, noting that the complaint failed to allege specific facts showing that the individual defendants had actual knowledge of any material misrepresentation or omission. It remains to be seen whether the Sixth Circuit's new approach to corporate scienter will expand to, and be similarly applied in, the other circuit courts and/or whether it will contribute to any eventual trip to the Supreme Court to harmonize the various circuit approaches to imputation. Pending further percolation, the more immediate question is whether yet another standard for pleading corporate scienter will have any meaningful effect more broadly on whom plaintiffs choose to name as defendants in Section 10(b) litigation.

Federal Extender Statutes and Statutes of Repose: The Implications of *Waldburger* Remain Unsettled

Earlier this month, the Supreme Court declined to grant *certiorari* a second time in Nomura Home Equity Loan, Inc.'s ongoing battle in the Tenth Circuit with the National Credit Union Administration (NCUA). Once again, the Supreme Court deferred an opportunity to clarify whether a federal extender statute (in this case, a provision included in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)) applicable to claims brought by the NCUA against lenders like Nomura was intended to displace the Securities Exchange Act's three-year statute of repose. The Tenth Circuit held in 2013 that the extender provision in FIRREA "established a universal time frame for the [NCUA] to bring any actions on behalf of credit unions placed into conservatorship or receivership," notwithstanding other potentially applicable statutes of limitations or statutes of repose, and the Supreme Court granted *certiorari* to review that decision, *National Credit Union Administration Board v. Nomura Home Equity Loan, Inc*., 764 F.3d 1199 (2014). Before oral argument, however, the Supreme Court reversed and remanded for reconsideration in light of *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014). In *Waldburger*, the Supreme Court addressed similar questions raised by a different federal law (in that case, one applicable to environmental claims) and held that a state's statute of repose was not pre-empted. Upon reconsideration, the Tenth Circuit reinstated its decision, holding that the federal statute addressed in *Waldburger* concerned a claim's accrual date and was substantially different from the FIRREA extender statute, which "plainly establishes its own exclusive time limits for NCUA enforcement actions and displaces all others." *Nat'l Credit Union Admin. Bd*., 764 F.3d at 1209.

The Supreme Court's decision to deny *certiorari* was surprising in light of the stakes involved in the expansive catalog of similar cases brought around the nation by the NCUA, the Federal Housing Finance Agency and the Federal Deposit Insurance Corporation (FDIC). For example, the two failed credit unions at issue in *Nomura* purchased a total of $1.74 billion in mortgage-backed securities and allegedly incurred "staggering" losses when foreclosure rates increased. Indeed, as a result of the mixed extender statute rulings from courts nationwide, much uncertainty in this area remains and likely will continue to prevail until the Supreme Court chooses to step into the fray again. For instance, in *F.D.I.C. v. Chase Mortgage Financial Corp.*, No. 12 Civ. 6166(LLS), 2014 WL 4354671 (S.D.N.Y. Sept. 2, 2014), a district court for the Southern District of New York determined that the FIRREA extender statute applicable to claims brought by the FDIC was not intended to alter (*i.e.*, pre-empt) the applicable statute of repose, and held that the FDIC's claims were barred. *Id.* at *5. But in *National Credit Union Admin. Board v. Morgan Stanley & Co*., No. 13 Civ. 6705 (DLC), 2014 WL 5017822 (S.D.N.Y. Sept. 30, 2014), the court adopted the Tenth Circuit's pre-emption reasoning from *Nomura*, holding that the NCUA's claims could move forward. *Id.* at *3.

These decisions and others evince the need for further clarification in this area, and several forthcoming appellate court decisions can be expected to be monitored closely by stakeholders and their advisers. In the Second Circuit, the Court of Appeals will hear the FDIC's appeal in *Chase*, and the Ninth and Fifth Circuits are also poised to decide similar cases later in 2015 or early 2016. *National Credit Union Administration v. Goldman Sachs & Co*., No. 14-55309 (9th Cir.) (NCUA extender provision); and *FDIC v. Merrill Lynch Pierce Fenner & Smith, Inc*., No. 14-51055 (5th Cir.) (FDIC extender provision). Although many observers felt that conditions were ripe for the Supreme Court to address more promptly the issue most recently raised in *Nomura*, another opportunity may present itself quickly if one or more of the forthcoming appellate decisions conflicts with the Tenth Circuit's analysis in *Nomura.*